



# **Tobacco Indemnification and Community Revitalization Commission**

Financial Statements

Fiscal Year 2012

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

(Unaudited)

As management of the Tobacco Indemnification and Community Revitalization Commission ("Commission"), we offer readers of the Commission's financial statements this narrative overview and analysis of the financial activities of the Commission for the fiscal year ended June 30, 2012.

### Financial Highlights

- The assets of the Commission exceeded its liabilities at the close of fiscal year 2012 by \$768.8 million (net assets).
- The Commission's unrestricted net assets decreased by \$36.4 million from the prior year and restricted net assets decreased by \$25.7 million from the prior year.
- At the end of the fiscal year, the Commission's restricted fund balance for the Special Revenue Fund was \$293.3 million with \$88.8 million of this amount remaining in the Endowment. The committed fund balance was \$94.5 million, and the assigned fund balance was \$381.0 million with \$337.3 million of this amount remaining in the Endowment.

### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Commission's basic financial statements. The Commission's basic financial statements are comprised of two components: 1) combined fund financial statements and government-wide financial statements, and 2) notes to the financial statements.

### Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commission uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Commission are governmental funds.

### Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues,

expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Through the Tobacco Settlement Financing Corporation, the Commission securitized half of its future Master Settlement Agreement (MSA) payments in 2005 and the remaining half in 2007, receiving total net proceeds of \$1.0 billion, which were deposited into the Tobacco Indemnification and Community Revitalization Endowment (“Endowment”) held by the Treasurer of Virginia. The Commission will no longer receive MSA revenue until the bonds are fully paid, estimated to be in 2032, but potentially as late as 2047 (pursuant to the indenture) when the MSA revenue will revert back to the Commission.

The Special Revenue Fund accounts for amounts transferred from the Endowment used for community revitalization projects and indemnifying tobacco farmers and other revenues deposited to the Tobacco Indemnification and Community Revitalization Fund. The Endowment Special Revenue Fund reflects proceeds and earnings from the securitization of the Commission’s future MSA funds, less amounts transferred to the Special Revenue Fund.

The Commission adopts an annual budget within the limits set forth in Section 3.2-3104, *Code of Virginia*. A budgetary comparison statement has been provided. The Commission approved several transfers and redistributions of funds from prior year balances between designated purposes during the year. This statement does not reflect all of the grant award commitments made by the Commission in fiscal year 2012 since grants are paid on a reimbursement basis and eligibility requirements may not have been met as of June 30, 2012.

#### Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Commission’s finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the Commission’s assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Commission is improving or deteriorating.

The statement of activities presents information showing how the Commission’s net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in the future.

#### Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

#### Financial Analysis of the Commission’s Governmental Funds

The focus of the Commission’s governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Commission’s financing requirements.

At June 30, 2012, the Commission's governmental fund balance was \$768.8 million, a decrease of \$62.0 million from the prior year. Of the total fund balance, \$293.3 million is restricted to capital expenditures by the bond indenture pursuant to IRS restrictions on the use of tax-exempt proceeds. Of this restricted fund balance, \$204.5 million in the Special Revenue Fund represents grant awards approved by the Commission for capital projects that have not yet been disbursed. The remaining \$88.8 million in restricted fund balance is in the Endowment Special Revenue Fund to be transferred to the Special Revenue Fund, subject to certain annual restrictions on transfers. The committed fund balance of \$94.5 million represents grant awards approved by the Commission that have not yet been disbursed. The assigned fund balance of \$381.0 million is intended to be used by the Commission for community revitalization projects. Of this assigned fund balance, \$337.3 million remains in the Endowment Special Revenue Fund to be transferred to the Special Revenue Fund in the future.

### Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of the Commission's financial position. Assets for the Commission exceeded liabilities by \$768.8 million.

Most of the Commission's net assets are unrestricted with amounts held in the Special Revenue Fund available to be used to meet the Commission's ongoing obligations to citizens and creditors. A small portion of the Commission's net assets reflects an investment in capital assets. The Commission uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

### Commission's Net Assets

	Governmental Activities	
	<u>Fiscal Year 2012</u>	<u>Fiscal Year 2011</u>
Assets:		
Current and other assets	\$777,209,686	\$840,165,445
Capital assets	<u>72,750</u>	<u>101,703</u>
Total assets	<u>777,282,436</u>	<u>840,267,148</u>
Liabilities:		
Current and other liabilities	8,371,835	9,289,427
Long-term liabilities	<u>145,151</u>	<u>167,344</u>
Total liabilities	<u>8,516,986</u>	<u>9,456,771</u>
Net assets:		
Invested in capital assets, net of related debt	917	1,703
Restricted	293,324,251	318,969,899
Unrestricted	<u>475,440,282</u>	<u>511,838,775</u>
Total net assets	<u><u>\$768,765,450</u></u>	<u><u>\$830,810,377</u></u>

The Commission's net assets decreased by \$62.0 million, most of which is attributable to indemnification and community revitalization disbursements being made from balances transferred out of the Endowment.

### Commission's Revenues and Expenditures

	Fiscal Year 2012	Fiscal Year 2011
Revenues:		
Other income	\$442,391	\$504,093
Interest, dividends, and other investment income	29,756,641	40,363,666
Unrealized gain on investments held by the Treasurer	9,798,124	0
Total revenues	39,997,156	40,867,759
Expenditures:		
Tobacco settlement expense:		
Administration	2,732,631	3,117,238
Indemnification payments	9,699,367	9,863,391
Community revitalization	89,609,299	110,950,510
Unrealized loss on investments held by the Treasurer	0	9,830,781
Depreciation	786	721
Total expenditures	102,042,083	133,762,641
Change in net assets	- \$62,044,927	- \$92,894,882

The decrease in total expenditures is primarily attributable to a lesser amount of community revitalization grants being disbursed this fiscal year.

### Budget for Fiscal Year 2013

The Commission approved a budget of \$78.1 million for fiscal year 2013, an overall decrease of more than 20 percent from the prior year final budget. This decrease is primarily due to the fulfillment of the Commission's obligation to tobacco producers and quota owners, concluding the tobacco indemnification program in 2012. The Commission anticipates grant awards in fiscal year 2013 that will obligate all of the assigned fund balance in the Special Revenue Fund plus a portion of the Endowment Special Revenue Fund.

### Request for Information

This financial report is designed to provide a general overview of the Commission's finances for all those with an interest in the Commission's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, Tobacco Indemnification and Community Revitalization Commission, 701 East Franklin Street, Suite 501, Richmond, Virginia 23219.

## **FINANCIAL STATEMENTS**

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION  
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUNDS BALANCE SHEET  
As of June 30, 2012

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Net Assets
<b>ASSETS:</b>				
Cash held by the Treasurer of Virginia (Note 2)	\$ 39,636,199	\$ -	\$ -	\$ 39,636,199
Cash equivalents held by the Treasurer of Virginia (unrestr endwmt) (Note 2)	4,215,685	-	-	4,215,685
Cash equivalents held by the Treasurer of Virginia (restricted funds) (Note 2)	13,277,214	-	-	13,277,214
Investments held by the Treasurer of Virginia (unrestricted) (Note 2)	103,617,906	337,265,310	-	440,883,216
Investments held by the Treasurer of Virginia (restricted funds) (Note 2)	176,287,583	88,762,070	-	265,049,653
Other receivables	99,266	-	-	99,266
Prepaid items	4,804	-	-	4,804
Grant advances (Note 6)	14,043,649	-	-	14,043,649
Intangible assets	-	-	71,833	71,833
Capital assets (Note 1)	-	-	917	917
Total assets	<u>\$ 351,182,306</u>	<u>\$ 426,027,380</u>	<u>\$ 72,750</u>	<u>\$ 777,282,436</u>
<b>LIABILITIES:</b>				
Accounts payable	148,231	-	-	148,231
Accrued payroll	65,962	-	-	65,962
Grants payable (Note 6)	8,028,858	-	-	8,028,858
Indemnification payments payable (Note 7)	128,784	-	-	128,784
Compensated absences (Note 1)	-	-	73,318	73,318
Other Liabilities	-	-	71,833	71,833
Total liabilities	<u>8,371,835</u>	<u>-</u>	<u>145,151</u>	<u>8,516,986</u>
<b>FUND BALANCES/NET ASSETS:</b>				
<b>Fund Balances:</b>				
Restricted (Note 10)	204,562,182	88,762,070	(293,324,252)	-
Committed	94,517,250	-	(94,517,250)	-
Assigned	43,731,039	337,265,310	(380,996,349)	-
Total liabilities and fund balances	<u>\$ 351,182,306</u>	<u>\$ 426,027,380</u>		
<b>Net assets:</b>				
Invested in capital assets, net of related debt			917	917
Restricted (Note 10)			293,324,251	293,324,251
Unrestricted			475,440,282	475,440,282
Total net assets			<u>\$ 768,765,450</u>	<u>\$ 768,765,450</u>

The accompanying notes are an integral part of the financial statements.



TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION  
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,  
EXPENDITURES, AND CHANGES IN FUND BALANCE  
For the Fiscal Year Ended June 30, 2012

	Special Revenue Fund	Endowment Special Revenue Fund (Note 10)	Adjustments (Note 1-F)	Statement of Activities
<b>REVENUES:</b>				
Interest, dividends, and other investment income (Note 2)	\$ -	\$ 29,756,641	\$ -	\$ 29,756,641
Other income	442,391	-	-	442,391
Unrealized gain on investments held by the Treasurer	-	9,798,124	-	9,798,124
Total revenues	442,391	39,554,765	-	39,997,156
<b>EXPENDITURES:</b>				
Tobacco settlement expense:				
Administration (Note 8)	2,726,658	-	5,973	2,732,631
Indemnification payments (Note 7)	9,699,367	-	-	9,699,367
Community revitalization (Note 6)	89,609,299	-	-	89,609,299
Depreciation (Note 1)	-	-	786	786
Total expenditures	102,035,324	-	6,759	102,042,083
Revenues Over (Under) Expenditures	(101,592,933)	39,554,765	62,038,168	-
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers In	98,720,836	-	-	98,720,836
Transfers Out	-	(98,720,836)	-	(98,720,836)
Total Other Financing Sources (Uses)	98,720,836	(98,720,836)	-	-
Excess (deficiency) of revenues and transfers in over expenditures and transfers out	(2,872,097)	(59,166,071)		
Change in net assets			(62,044,927)	(62,044,927)
Fund balance/net assets, July 1, 2011	345,682,568	485,193,451	(65,642)	830,810,377
Fund balance/net assets, June 30, 2012	\$ 342,810,471	\$ 426,027,380	\$ (72,401)	\$ 768,765,450

The accompanying notes are an integral part of the financial statements.

TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
BUDGETARY COMPARISON - CASH BASIS  
SPECIAL REVENUE FUND  
For the Fiscal Year Ended June 30, 2012

	Original Budget	Final Budget	Actual	Variance Favorable (Unfavorable)
REVENUES:				
Other income	-	-	438,569	438,569
Total revenues	-	-	438,569	438,569
EXPENDITURES:				
Administration	3,325,545	3,325,545	2,882,444	443,101
Indemnification payments (Note 7)	10,259,008	10,259,008	9,664,030	594,978
Community revitalization (Note 6)	71,500,000	85,548,838	91,304,647	(5,755,809)
Total expenditures	85,084,553	99,133,391	103,851,121	(4,717,730)
Revenues over (under) expenditures	(85,084,553)	(99,133,391)	(103,412,552)	(4,279,161)
OTHER FINANCING SOURCES (USES):				
Transfers In	109,062,428	109,062,428	98,720,836	(10,341,592)
Fund balance, July 1, 2011	341,726,303	341,726,303	341,726,303	-
Fund balance, June 30, 2012	<u>\$ 365,704,178</u>	<u>\$ 351,655,340</u>	<u>\$ 337,034,587</u>	<u>\$(14,620,753)</u>

The accompanying notes are an integral part of the financial statements.

## **NOTES TO FINANCIAL STATEMENTS**

# TOBACCO INDEMNIFICATION AND COMMUNITY REVITALIZATION COMMISSION

## NOTES TO FINANCIAL STATEMENTS

### FOR THE YEAR ENDING JUNE 30, 2012

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### A. Reporting Entity

The Tobacco Indemnification and Community Revitalization Commission (Commission) was established on July 1, 1999, by Chapters 880 and 962 of the 1999 Virginia Acts of Assembly, and operates as a body corporate and political subdivision of the Commonwealth of Virginia. The Commission's major activities are to compensate tobacco farmers in the Commonwealth for the decline of tobacco quota and to revitalize tobacco-dependent communities.

The Commission is a component unit of the Commonwealth. A separate report is prepared for the Commonwealth, which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Commission is an integral part of the reporting entity of the Commonwealth; accordingly, the financial statements of the Commission are included in the financial statements of the Commonwealth as a part of the reporting entity.

##### B. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant awards and similar items are recognized as expenditures as soon as the recipient has met all eligibility requirements.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available.

- Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Commission considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Interest associated with the current fiscal period is reported on an accrual basis. All other revenue items are considered to be measurable and available only when cash is received by the Commission.
- Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences, claims, and judgments are recorded only when payment is due.

The cash basis of accounting is used during the year.

C. Fund Accounting

The accounts of the Commission were developed to account for specific financial activities. Resources were allocated to and accounted for in a special revenue fund, the “Tobacco Indemnification and Community Revitalization Fund,” established under Section 3.2-3106, Subsection B of the Code of Virginia. Special revenue funds account for transactions related to resources received and used for restricted or specific purposes.

Fund balances on the fund financial statements are classified as Restricted, Committed, or Assigned in accordance with Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The Restricted fund balance includes all funds in the Tobacco Indemnification and Community Revitalization Special Revenue Funds that are restricted to specific purposes by the bond indenture from which those funds were derived pursuant to IRS restrictions on the use of tax-exempt securitization proceeds. The Committed fund balance comprises unrestricted funds that have been approved by the Commission for specific grants that have not yet been disbursed. The Assigned fund balance includes funds that have been approved by the Commission through the annual budgeting process for specific project areas, such as Education, Economic Development, or Agribusiness, that have not yet been awarded for specific grants, and any other funds not restricted or committed.

D. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets, are reported in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Capital assets also include intangible assets, such as software licenses, that cost more than \$100,000 and have a benefit period exceeding one year. Such assets are recorded at the total cost of the contractual agreement and depreciated over the contract period.

Computer equipment is depreciated using the straight-line method over an estimated useful life of five years. Capital asset activity for the year ended June 30, 2012, is summarized as follows:

	Beginning Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012
Computer equipment	\$11,931	\$ -	\$ -	\$11,931
Software licenses	125,000	-	-	125,000
Less Accumulated Depreciation	<u>35,228</u>	<u>28,953</u>		<u>64,181</u>
Ending Balance	<u>\$101,703</u>	<u>28,953</u>	<u>\$ -</u>	<u>\$72,750</u>

E. Compensated Absences

Compensated absences represent the amounts of vacation, sick, and compensatory leave earned by the Commission's employees, but not taken at June 30, 2012. Compensated absences were calculated in accordance with Governmental Accounting Standards Board (GASB) Statement No. 16, *Accounting for Compensated Absences*. This statement requires the accrual of the following: (1) Sick leave earned by employees who, while not currently vested for payment, will probably attain the years of service required to vest, and (2) Social Security and Medicare taxes to be paid by the Commission on all accrued compensated absences.

F. Adjustments

The adjustments column represents the recording of Capital Assets and Compensated Absences for the Statement of Net Assets and the related effect of these transactions on the Statement of Activities. Governmental fund statements do not reflect Capital Assets and Compensated Absences.

G. Budgets and Budgetary Accounting

The Commission's budget was established by the Commission based on investment earnings and allowable withdrawals from the Tobacco Indemnification and Community Revitalization Endowment.

The budget is prepared principally on a cash basis. Since a cash basis budget differs from generally accepted accounting principles (GAAP), a reconciliation of actual data reported on a cash basis to actual data reported on a GAAP (modified accrual) basis is presented in Note 3.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash, Cash Equivalents and Investments

The GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment to GASB No. 3, modified previous disclosure requirements related to investment risk. This statement requires investment risk disclosures for credit risk, including custodial credit risk and concentrations of credit risk, interest rate risk, and foreign currency risk.

A. Cash and Cash Equivalents

Cash deposits are covered by the Federal Deposit Insurance Corporation (FDIC) and collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq. of the Code of Virginia (1950), as amended. Restricted and unrestricted cash equivalents of the special revenue fund are held in the name of the Commission with the Treasury Board serving as trustee and total \$57,129,098 as of June 30, 2012.

B. Investments

Authorized Investments

In accordance with the State Treasurer and the Treasury Board investment policy, the funds held by the Treasurer of Virginia are invested in accordance with Sections 3.2-3104 and 55-268.11 et seq. of the Code of Virginia.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Commission has elected the Segmented Time Distribution method of disclosure. As of June 30, 2012, the Commission had the following investments and maturities held by the Treasurer of Virginia:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in Years)</u>			
		<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More Than 10</u>
U.S. Treasury and Agency Securities	\$73,031,898	\$4,326,910	\$54,419,196	\$9,617,219	\$4,668,573
Corporate Bonds	190,813,527	12,652,536	98,162,312	79,013,122	985,557
Corporate Mortgage Backed	14,914,336			449,932	14,464,405
Municipal Securities	275,554,234	14,586,005	92,574,363	111,986,969	56,406,897
Asset Backed Securities	43,544,692		22,847,569	14,005,597	6,691,526
Agency Mortgage Backed Securities	108,074,182	2,840,020	4,592,991	10,175,491	90,465,681
Money Market Funds	17,492,899	17,492,899			
Total	<u>\$723,425,768</u>	<u>\$51,898,370</u>	<u>\$272,596,430</u>	<u>\$225,248,330</u>	<u>\$173,682,638</u>

Credit Risk

Credit risk is the risk that obligations to the Commission will not be fulfilled by an issuer or other counterparty to an investment. The State Treasurer and Treasury Board investment guidelines place emphasis on securities of high credit quality and marketability.

The following table presents the credit ratings for investments as of June 30, 2012. The ratings presented below are using Standard & Poor's (S&P) and Moody's Investors Service (Moody's) rating scales.

Investment	Amount	Rating Agency	Rating	% of Portfolio
Agency Mortgage Backed Securities	\$108,074,182	Standard & Poor's	AA+	14.94%
U.S. Treasury and Agency Securities	73,031,898	Standard & Poor's	AA+	10.10%
Municipal Securities	55,640,814	Standard & Poor's	AAA	7.69%
Municipal Securities	50,094,054	Standard & Poor's	AA	6.92%
Municipal Securities	47,008,565	Standard & Poor's	AA+	6.50%
Corporate Bonds	44,882,368	Standard & Poor's	A	6.20%
Corporate Bonds	42,096,552	Standard & Poor's	A-	5.82%
Municipal Securities	29,569,255	Standard & Poor's	AA-	4.09%
Asset Backed Securities	25,347,390	Standard & Poor's	AAA	3.50%
Corporate Bonds	23,845,652	Standard & Poor's	A+	3.30%
Municipal Securities	23,199,578	Moody's	Aa2	3.21%
Municipal Securities	18,437,873	Standard & Poor's	A+	2.55%
Municipal Securities	13,289,103	Moody's	Aa3	1.84%
Money Market Funds	13,277,214	Standard & Poor's	Aaa-mf	1.84%
Corporate Bonds	12,281,356	Standard & Poor's	AA	1.70%
Corporate Bonds	10,940,497	Standard & Poor's	AA-	1.51%
Corporate Bonds	10,041,916	Moody's	Baa2	1.39%
Corporate Bonds	9,226,618	Moody's	A1	1.28%
Corporate Mortgage Backed	9,148,477	Standard & Poor's	AAA	1.26%
Municipal Securities	9,130,160	Standard & Poor's	A	1.26%
Municipal Securities	8,862,860	Standard & Poor's	A-	1.23%
Corporate Bonds	8,128,487	Moody's	A3	1.12%
Corporate Bonds	7,275,339	Moody's	Baa1	1.01%
Corporate Bonds	7,231,338	Moody's	A2	1.00%
Asset Backed Securities	6,595,966	Standard & Poor's	AA-	0.91%
Asset Backed Securities	5,514,137	Moody's	Aaa	0.76%
Municipal Securities	5,159,642	Moody's	A2	0.71%
Municipal Securities	5,108,580	Moody's	Aa1	0.71%
Money Market Funds	4,215,685	Standard & Poor's	AAA-m	0.58%
Corporate Bonds	4,203,864	Moody's	Aa3	0.58%
Municipal Securities	4,144,125	Moody's	A1	0.57%
Asset Backed Securities	3,247,320	Standard & Poor's	A+	0.45%
Corporate Bonds	3,214,218	Moody's	Aa2	0.44%
Corporate Bonds	3,067,080	Standard & Poor's	BBB+	0.42%
Corporate Bonds	2,960,130	Standard & Poor's	AAA	0.41%
Asset Backed Securities	2,839,880	Standard & Poor's	A-	0.39%
Corporate Mortgage Backed	2,806,920	Moody's	Aaa	0.39%
Municipal Securities	2,656,918	Moody's	Aaa	0.37%
Corporate Mortgage Backed	2,509,007	Standard & Poor's	AA+	0.35%
Municipal Securities	2,169,545	Standard & Poor's	BBB	0.30%
Corporate Bonds	1,418,111	Standard & Poor's	AA+	0.20%
Municipal Securities	1,083,160	Standard & Poor's	A-1+	0.15%
Corporate Mortgage Backed	449,932	Standard & Poor's	A+	0.06%
	<u>\$723,425,768</u>			<u>100%</u>



### Concentration of Credit Risk

Concentration of credit risk is related to the risk of loss that may be attributed to the magnitude of a government's investment in a single issuer. The Treasury Board investment guidelines require each portfolio be diversified with no more than five percent of the total market value of its investments invested in the securities of any single issuer. This limitation does not apply to the U.S. Government, or agency thereof, or U.S. Government sponsored corporation securities and fully insured and/or collateralized certificates of deposit. There is no concentration of investments in any one organization that represents more than five percent of the market value of the endowment as of June 30, 2012.

### Custodial Credit Risk

Custodial credit risk is the risk that, in the event of failure of the counterparty, the Commission may not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All securities are held in the name of the Commission with oversight from the Treasurer of Virginia. There is no custodial credit risk in the endowment as of June 30, 2012.

### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. There is no foreign currency risk exposure in the Commission's investments as of June 30, 2012.

## 3. RECONCILIATION OF BUDGETARY FUND BALANCE TO GAAP FUND BALANCE

The accompanying Statement of Revenues, Expenditures, and Changes in Fund Balance – Budgetary Comparison – Cash Basis – Special Revenue Fund presents a comparison of the legally adopted budget prepared on a cash basis with actual data prepared on a cash basis. To enhance this comparison, actual data on a cash basis is reconciled to actual data on a GAAP basis as follows:

Fund balance, Budgetary basis, June 30, 2012	\$337,034,587
Deduct: accrued expenses	(8,371,835)
Add: receivables, advances, and prepaid Items	<u>14,147,719</u>
Fund balance, GAAP basis, June 30, 2012	<u>\$342,810,471</u>

## 4. PENSION PLAN AND OTHER RETIREMENT BENEFITS

Employees of the Tobacco Indemnification and Community Revitalization Commission are treated as state employees for purposes of participation in the Virginia Retirement System (VRS), health insurance, and all other employee benefits offered by the Commonwealth to its classified employees. The VRS also administers life insurance and health related plans for retired employees. Information relating to these plans is only available at the statewide level in the CAFR. The Commonwealth, not the Commission, has overall responsibility for contributions to these plans.

## 5. OPERATING LEASES

The Commission entered into a 36-month agreement in June 2010 to lease office equipment beginning in fiscal year 2011. The operating lease contains the provision that the Commission may renew the operating lease at the expiration date of the lease on a month-to-month basis. Rental expense for the Commission under this operating lease for the year ended June 30, 2012, was \$8,201. The Commission has, as of June 30, 2012, \$7,704 in minimum rental payments due under this lease for 2013.

## 6. COMMUNITY REVITALIZATION EXPENDITURES

The Commission awarded grants totaling \$116,601,685 in fiscal year 2012 to various localities and other entities for community revitalization projects, including regional economic development projects, educational programs, research and development initiatives, megasite development, and other special projects in Southern and Southwest Virginia. Of the total amount awarded since the inception of the Commission, \$218,768,695 is not reflected in these statements since eligibility requirements were not met as of June 30, 2012, in accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*. This amount not reflected in the statements includes grants awarded in prior years that have not yet been paid. Grants payable include amounts awarded to grantees with all contingencies met but unpaid as of June 30, 2012. Grant advances include amounts disbursed to grant recipients who have not incurred expenses as of June 30, 2012.

## 7. INDEMNIFICATION PAYMENTS

Indemnification payments represent amounts paid to tobacco producers and quota owners as compensation for the adverse economic effects resulting from the loss in tobacco production opportunities associated with a decline in tobacco quota. Indemnification Payments Payable include amounts payable to recipients who as of June 30, 2012, met the eligibility requirement of submitting the appropriate verification form by the initial deadline. The Commission will have fulfilled its obligation to tobacco producers and quota owners by the end of calendar year 2012.

## 8. ADMINISTRATION

### Indemnification Costs

Administration expenditures include \$334,200 paid to Troutman Sanders, L.L.P., to validate payees and update the database for calculating payment amounts related to the indemnification payments.

### Master Settlement Agreement (MSA) Enforcement

Pursuant to the 2011 Appropriation Act, administration expenditures include \$244,268 for the Commission's share of the Office of the Attorney General's and Tax Department's expenses related to the enforcement of the 1998 MSA and Section 3.2-4201, Code of Virginia.

### Central Service Agencies Charge

Administration expenditures include \$88,077 for expenses incurred by central service agencies on behalf of the Commission, pursuant to the 2011 Appropriation Act.

### Agency Service Costs

Administration expenditures include \$50,000 of Agency Service Costs paid to the Virginia Department of Agriculture and Consumer Services (DACS). DACS serves as the fiscal agent for the Commission. Agency Service Costs consist of the amounts DACS charges the Commission for the costs DACS incurs to provide fiscal and administrative services to the Commission.

## 9. RISK MANAGEMENT

The Commission is exposed to various risks of loss related to torts; theft, or damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The Commission has purchased Virginia Local Government Risk Management Plan liability insurance through the Department of the Treasury, Division of Risk Management. Commercial insurance for property coverage and worker's compensation plans have been purchased from private insurers since the Commonwealth does not provide such coverage for the Commission. The Commission participates in the state employee health care plan administered by the Department of Human Resource Management. The Commission pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's insurance plans is available at the statewide level in the CAFR.

## 10. SECURITIZATION

In May 2005, the Governor, with the Commission's endorsement, authorized the sale to the Tobacco Settlement Financing Corporation (the Corporation) of one-half of the Commission's allocation of revenues derived from the MSA, pursuant to Chapters 482 and 488 of the 2002 Virginia Acts of Assembly. The Corporation sold tax-exempt bonds, the proceeds of which are restricted to the purchase of capital assets. The net proceeds to the Tobacco Indemnification and Community Revitalization Endowment were \$389,776,674 on May 16, 2005.

In 2007, the Governor, with the Commission's endorsement, authorized the sale to the Corporation of the other half of the Commission's allocation of revenues derived from the MSA. The Corporation sold taxable bonds and restructured the previously issued tax-exempt bonds such that all proceeds from the 2007 sale are not restricted to the purchase of capital assets. However, all of these funds are restricted to the purpose of promoting the goals of the Commission as enumerated by §3.2-3101 of the Code of Virginia. The net proceeds to the Tobacco Indemnification and Community Revitalization Endowment from the bond sale and restructuring were \$613,994,236 on May 3, 2007. The Commission will no longer receive MSA revenue until the bonds are fully paid, estimated to be in 2032, but potentially as late as 2047 (pursuant to the indenture) when the MSA revenue will revert back to the Commission. The Commission and the Commonwealth did not guarantee in any aspect the future MSA revenue to the bondholders.

The Commission is required to transfer annually all interest income from the Endowment and may transfer up to 15 percent of the corpus of the Endowment into the Tobacco Indemnification and Community Revitalization Fund, which is reflected under the Special Revenue Fund column. In

fiscal year 2012, the Commission transferred \$98,720,836, including \$30,397,251 in interest earnings through February 2012, from the Endowment to the Tobacco Indemnification and Community Revitalization Fund. The remaining Endowment balance includes interest earned on the Endowment from March 1, 2012, through June 30, 2012.



# Commonwealth of Virginia

*Auditor of Public Accounts*

Walter J. Kucharski  
Auditor of Public Accounts

P.O. Box 1295  
Richmond, Virginia 23218

October 3, 2012

The Honorable Robert F. McDonnell  
Governor of Virginia

The Honorable John M. O'Bannon, III  
Chairman, Joint Legislative Audit  
And Review Commission

Commission Members  
Virginia Tobacco Indemnification and  
Community Revitalization Commission

## INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the governmental activities and each major fund of the **Virginia Tobacco Indemnification and Community Revitalization Commission** (Commission), a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2012, which collectively comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Commission as of June 30, 2012, the respective changes in financial position, and the respective budgetary comparison for the special revenue fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses

to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with Government Auditing Standards, we have also issued our report dated October 3, 2012 on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

  
AUDITOR OF PUBLIC ACCOUNTS

LJH/alh